At the core of this constitutional inquiry is a set of very practical questions: What are the real interstate economic impacts of state tax incentives like Ohio's ITC? Does the adoption of tax incentives by one state influence the level of economic activity in other states or otherwise impair the free flow of trade across state borders? Do state tax incentives actually yield economic benefits for states that adopt them? In order to assess whether the Ohio ITC and others like it impermissibly burden interstate commerce or actually promote productive economic competition between the states, it is therefore helpful to consider what we know as an empirical matter about the actual economic effects of such policies.

In its recent Commerce Clause jurisprudence, the Court has underscored the importance of examining the practical economic impact of challenged state policies.[3] For instance, in *American Trucking Assocs., Inc. v. Michigan Public Serv. Comm.*, 125 S.Ct. 2419 (2005), the Court held that Michigan's $100 flat fee imposed on trucks that "undertake point-to-point hauls between Michigan cities," *id.* at 2422, did not violate the Commerce Clause, *id.* at 2423. In reaching this conclusion, the Court emphasized that "the record contains little, if any, evidence that the $100 fee imposes *any significant practical burden* upon interstate trade." *Id.* at 2423-24 (emphasis added). Particularly given

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[3] In a forthcoming article, Professor Kirk Stark and Federal Reserve Bank economist Daniel Wilson discuss the constitutional importance of considering the economic effects of tax incentives in the context of the *Cuno* controversy. *See* Kirk J. Stark & Daniel J. Wilson, *What Do We Know About the Interstate Economic Effects of State Tax Incentives?*, 4 GEORGETOWN JOURNAL OF LAW & PUBLIC POLICY (forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=868692.

the Court's central institutional role in resolving interstate commercial disputes, *Gibbons v. Ogden*, 22 U.S. 1 (1824), we believe it appropriate for the Court to give attention to the practical economic effects of state tax incentives in considering this case.[4]

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[4] The significance of undertaking such an analysis is highlighted by the frequency with which *amici* for the Petitioners invoke the practical economic impact of state tax incentives to support arguments in favor of their constitutionality. Indeed, a prominent theme in the *amici* briefs for Petitioners is that state tax incentives foster healthy economic competition between the states. *See* AlphaGenetics, Inc. *et al. Amici Curiae* Brief, at 19 (arguing that "the decision of the Court of Appeals will result in the unintended consequence of impeding innovation among early-stage companies and impacting on entrepreneurship"); City of New York *Amicus Curiae* Brief, at 2 (stating that an investment tax credit "helps to encourage increased local business activity"); National Governors Association, *et al. Amicus Curiae* Brief, at 13 (stating that "while there is no record here, the ITC likely functions in a manner that promotes interstate commerce" by reducing the purchase price of goods and serving as an export subsidy); Nissan *Amicus Curiae* Brief, at 25 (suggesting that Nissan's tax break package in Tennessee "transformed Tennessee's economy"); Pacific Legal Foundation *Amicus Curiae* Brief, at 3 (suggesting that state tax incentives like Ohio's promote "competitive federalism," "in which states compete with one another to provide the best regulatory regime for mobile citizens"); Tax Executives Institute, Inc. *Amicus Curiae* Brief, at 7 ("investment tax credits, along with an array of other tax incentives, are widely used by States to encourage growth in economically distressed areas, spur investment, increase jobs, and hence, enlarge the tax base."); Tax Foundation *Amicus Curiae* Brief, at 14 (stating that the sensitivity of companies like DaimlerChrysler to state tax systems "provides the opportunity for meaningful and beneficial tax competition among the States for jobs and investment"); The Right Place, Inc. and the City of Grand Rapids, Michigan *Amici Curiae* Brief, at 12 (arguing that if all states adopted a tax credit similar to the Ohio investment tax credit, "it would result in lower corporate taxes and more national commerce"). However, while these *amici* suggest that negative economic consequences would result from the elimination of state tax incentives like the Ohio ITC, there is a complete lack of empirical evidence provided to support this claim.

II. THE ECONOMIC EVIDENCE SHOWS THAT STATE TAX INCENTIVES, AT BEST, PRODUCE A ZERO-SUM COMPETITION AND, AT WORST, RESULT IN A NATIONAL ECONOMIC LOSS

This part addresses the most fundamental concern of the dormant Commerce Clause: What are the inter-state economic consequences of state tax incentives?

A. Tax incentive competition is at best a zero-sum game

To the extent that a state is successful in attracting more business investment through the offering of tax incentives, it does so at the expense of other states. That, in fact, is the stated rationale for incentive policies: to change the location choices of business firms. Moving business activity from one place to another has been described as a zero-sum game: the gain to one state is offset by a loss to another, with no net benefit to the nation. *See* Barry Rubin & Kurt Zorn, *Sensible State and Local Economic Development Policy*, 45 PUBLIC ADMINISTRATION REV. 333 (1985).

Recent studies on research and development (R&D) spending support this conclusion. While previous studies have looked at state tax levels and certain measures of economic growth in order to discern the influence of general tax reductions on economic activity, these more recent studies attempt to isolate the discrete effect of state tax incentives on firm investment behavior. In one recent study, for example, economist Dan Wilson of the Federal Reserve Bank examines firm-level data on research and development (R&D) spending in order to estimate how sensitive firm R&D spending is to its after-tax price or

"user cost," and specifically to state R&D credits. Daniel J. Wilson, *Beggar Thy Neighbor? The In-State vs. Out-of-State Impact of State R&D Tax Credits*, FEDERAL RESERVE BANK OF SAN FRANCISCO WORKING PAPER 08 (2005). Relying on comprehensive data of after-tax R&D prices, Wilson finds that state R&D tax credits do appear to spur R&D spending within the state adopting the credit. Wilson also finds, however, that the out-of-state effect is roughly opposite and equal in absolute value to the in-state effect. The key finding of Wilson's research that is most relevant for the dormant Commerce Clause analysis is the influence of R&D tax credits on R&D spending *in other states*. Thus, as the cost of research and development undertaken inside of State A decreases, as it would when State A enacts or increases R&D tax credits, the level of R&D activity undertaken outside of State A falls.

These results provide support for the view that a state's adoption of R&D tax credits has adverse practical effects on the level of R&D undertaken within other states. Over the past quarter-century, numerous states have adopted R&D tax credits, ostensibly to provide a friendly business climate for high-tech investment. *See* Daniel J. Wilson, *The Rise and Spread of State R&D Tax Credits*, FEDERAL RESERVE BANK OF SAN FRANCISCO ECONOMIC LETTER, Number 2005-26 (October 14, 2005). For example, California adopted its R&D tax credit in 1988, allowing businesses a credit equal to 20 percent of the excess of the taxpayer's "qualified research expenses" over a specified base amount.[5] Based on Wilson's findings, the

[5] For a description of California's R&D tax credit, see BRONWYN HALL & MARTA WOSINKA, THE CALIFORNIA R&D TAX CREDIT: DESCRIPTION, HISTORY, AND ECONOMIC ANALYSIS (1999).

expected effect of a state's adoption of such a credit would be an increase in R&D spending in that state and a corresponding decrease in other states. It is as though a single state has appropriated for itself the power to direct the geographical sourcing of R&D spending – precisely the sort of "regulation of interstate commerce" that the Court's dormant commerce clause jurisprudence is meant to foreclose.

B. Tax incentive competition produces economic inefficiency

When viewed from the perspective of the national economy, the evidence suggests that state tax incentive competition is likely more damaging than a zero-sum game: It is, in fact, a negative-sum game in that the distortions it creates produce inefficient locational decisions that result in a national economic loss. *See* Melvin L. Burstein & Arthur J. Rolnick, *Congress Should End the Economic War Among the States*, 9 THE REGION (Federal Reserve Bank of Minneapolis) 3 (March 1995). In order to understand the harmful national consequences of state tax incentives, we must first consider the range of factors that a business considers when choosing a location in which to build, relocate, or expand a facility:

i. Access (transport cost and reliability) to raw materials or components;

ii. Access to the major markets for the finished products;

iii. Availability of labor with needed skills and the productivity of that labor;

iv. Wage rates;

v. Employee health insurance costs;

vi. Energy and telecommunications services costs; and

vii. Quality of local public services, particularly those related to education and training of the labor force, infrastructure investment, and public safety.

Businesses naturally seek locations with the lowest resource cost. That is, they seek to minimize the costs of transporting raw materials or finished products, the total cost of labor embodied in the finished product, and the costs for energy, water, sewer, and communications services. These costs to the firm also reflect the real social costs associated with consumption of scarce resources. When firms minimize transport costs, for example, society gains: For a given volume of finished product, the economy consumes the minimum tons of concrete and gallons of gasoline required for the transportation services needed to produce and deliver those finished products. The efficient operation of the national economy requires that firms choose the least-cost locations, a result generally produced by the competitive pressures on firms to reduce costs.

The purpose of tax incentives is to change location decisions. Two Federal Reserve economists have argued that incentives, if they are effective in changing the location of economic activity, change the distribution of facilities from the set of least-cost locations as described above to one that consumes more resources and is therefore less efficient. *See* Burstein & Rolnick, *supra*. These economists describe this as a "negative-sum" result because the benefits and costs to local economies offset each other (the zero-sum game), but the losses to the national economy produce a negative sum.

One counter argument is that incentives simply reinforce the existing geographic pattern of costs. However, this argument does not save them from the charge of inefficiency. To the contrary, to the extent that incentives do reinforce existing cost patterns, they are entirely inefficient since the same location decisions would have been made in the absence of incentives. Incentives only make a difference when they trump economic considerations and induce inefficient location choices.[6]

There is an additional way in which incentive competition can produce net losses. When a business firm actually

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[6] We do not suggest that the Commerce Clause prohibits, or that sound economic development policy should avoid, all state policies that pursue other values at the cost of economic efficiency. First, the Commerce Clause, in this context, applies only to tax policy and leaves states free to pursue economic development or social policy goals by other means. *See New Energy*, 486 U.S. at 278 ("The Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description in connection with the State's regulation of interstate commerce. Direct subsidization of domestic industry does not ordinarily run afoul of that prohibition; discriminatory taxation of out-of-state manufacturers does."). Second, the Commerce Clause prohibits only those tax policies that seek to enrich one state by moving economic activity to that state from another state. The Commerce Clause does not prohibit states from using tax policy to encourage desired corporate behavior within a state, or even to encourage location decisions within a state that may be economically inefficient but meet other policy objectives. *Id.* Similarly, the Commerce Clause obviously does not limit the ability of the *federal* government to encourage location decisions based on factors other than economic efficiency. Rather, the basic constitutional limitation is a narrow one: States cannot use their sovereign taxing power to pursue the goal of strengthening their own economies by undermining the economic base of other states. In setting this policy, the framers of the Constitution were not only establishing an important rule to protect political and social harmony among the several states, they were also practicing fundamentally sound economic theory.

relocates an existing facility, it moves from a locality with the necessary public infrastructure and services already in place, to a locality that must expand services to accommodate the facility and the population growth that ensues. The result is redundant public investment in the old locale that must then be maintained with revenues from a smaller tax base, while resources must be committed to provision of new public investment in the new locale.[7] While these effects are felt locally, they represent real national economic costs.

C. Tax incentive competition harms long-term economic growth

As part of the interstate competition, one state's decision to provide tax incentives to businesses induces reciprocal behavior on the part of other states. In order to "win" the interstate competition for new business activity, states are therefore placed in the position of having to continually increase tax breaks to lure businesses. As a result of this "race to the bottom," over time the zero-sum game becomes more costly to states as they devote larger shares of their budgets to the provision of tax incentives.[8]

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[7] Several studies have estimated the cost of public investments, particularly streets and highways, necessitated by new business development. For a review of research on this topic see ALAN ALTSHULER & JOSE GOMEZ-IBANEZ, REGULATION FOR REVENUE: THE POLITICAL ECONOMY OF LAND USE EXACTIONS 77-96 (1993).

[8] In a study of 20 states that together accounted for 75% of the manufacturing investment in the U.S., Alan Peters and Peter Fisher documented the growth of incentive programs from 1990 to 1998 and found that the average set of state and local tax incentives for manufacturing activity had approximately doubled in value (measured as the percentage reduction in total state-local taxes) over that eight-year

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This country has a well-developed intergovernmental system that places responsibility on states and localities for providing the public services that businesses directly use and depend on: education for entrants into the labor force, police and fire service, and the provision of local infrastructure (such as streets, and water and sewer systems). Investment in these services provides the foundation for economic activity. Tax incentive competition undermines the ability of state and local governments to provide those services by diverting revenues to a costly and wasteful competition with one another. *See* Burstein & Rolnick, *supra*. As such it operates to degrade the quality of basic services that the nation needs to foster future growth.

D. Tax incentive competition does not enhance international competitiveness

Some have argued that incentive competition drives down the average level of state and local taxes on business activity in the U.S., which in turn makes the nation more competitive in the world economy. However, there is reason to be skeptical of this claim. For one, U.S. state and local taxes are a small part of the overall cost of doing business and are already quite low compared to other industrialized countries. Among the 30 nations in the Organisation for Economic Cooperation and Development, the U.S. ranks 29th in terms of total federal, state and

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period. ALAN PETERS & PETER FISHER, STATE ENTERPRISE ZONE PROGRAMS: HAVE THEY WORKED? 56-69 (2002); *see also* KENNETH THOMAS, COMPETING FOR CAPITAL 158-59 (2000) (finding that state and local business tax incentives and subsidies had grown in the 1990s and approached $49 billion in 1996).

local taxes as a percent of gross domestic product. *See* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, REVENUE STATISTICS 1965-2003 (2004). Furthermore, when one considers the range of economic factors that play a significant role in firm location decisions – transportation, wages, and productivity – there is obviously enormous variation across the globe. U.S. state-local taxes are inconsequential when compared to differences in wages between, for example, Ohio and China. Because of this, a reduction in Ohio taxes would not have a decisive influence on a firm's decision to locate in China.

Moreover, to the extent that international competitiveness is an important policy concern, it is not of constitutional importance here. To the contrary, under the explicit terms of the Commerce Clause, the regulation of international commerce is squarely within the domain of the federal government. U.S. Const. art. I, § 8, cl. 3 (leaving to Congress the power to "regulate Commerce with foreign Nations").

III. STATE TAX INCENTIVES DO NOT PRODUCE MEANINGFUL INTRASTATE ECONOMIC BENEFITS THAT JUSTIFY THEIR HARMFUL INTERSTATE EFFECTS

Once we understand the negative consequences of state tax incentives on the national economy, the question arises: Are they nevertheless worth it for the states that enact them? Under the Supreme Court's dormant Commerce Clause jurisprudence, even a discriminatory tax incentive may be upheld if "it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *New Energy*, 486 U.S. at 278. Do state tax incentives of the sort at issue here

produce the types of intrastate economic benefits that might still warrant their use? As we discuss in this section, the weight of the economic evidence suggests that the answer to this question is no. Specifically, we present evidence that the effects of state tax incentives on business location are small; incentives are costly to the states that offer them; and states have available to them a wide array of alternative economic development policies that are in fact cost-effective and beneficial to the national economy.

A. Tax incentives are at best marginally effective in altering business locations

Some state and local government officials believe that business tax incentives are an effective policy tool to promote economic development in their states and localities. This belief is not supported by the evidence. Economists have researched this issue extensively over the past three decades. In fact, over 75 studies have been conducted exploring the question: Do taxes, or tax incentives, produce growth in investment or jobs? *See* Michael Wasylenko, *Taxation and Economic Development: The State of the Economic Literature*, NEW ENGLAND ECON. REV. 37 (March-April 1997).[9] The general conclusion that

[9] Much of this research has investigated the effects of reductions in the level of taxation rather than the effects of tax incentives per se. However, a tax incentive is by definition a reduction in a tax, so that the effects of "tax reductions" or "incentives" on economic activity will be similar. In discussing the research literature, we will use the term "incentives" to refer to tax reductions of whatever form. In doing so, however, we are not suggesting that tax reductions be subject to same constitutional scrutiny as tax incentives. Indeed, the Court has made it clear that general reductions in state tax levels do not raise dormant Commerce Clause concerns. *See West Lynn Creamery*, 512 U.S. at 199

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can be drawn from this large body of research is that incentives are, at best, only marginally effective in changing the location of business activity. *See* ROBERT G. LYNCH, RETHINKING GROWTH STRATEGIES: HOW STATE AND LOCAL TAXES AND SERVICES AFFECT ECONOMIC DEVELOPMENT (2004); Alan Peters & Peter Fisher, *The Failures of Economic Development Incentives*, 70 J. OF THE AMERICAN PLANNING ASSOC. 27 (Winter 2004); Wasylenko, *supra*. In addition, recent research has called into question whether the location of new firms produces significant net benefits for the host community. *See* William F. Fox & Matthew N. Murray, *Do Economic Effects Justify the Use of Fiscal Incentives?*, 71 SOUTHERN ECON. J. 78 (2004). As a result, there is reason to believe that tax incentives are both costly and potentially counterproductive even to the states that use them "successfully."

Firms consider the whole range of factors discussed earlier (access, labor productivity and cost, energy cost, public services) when choosing a location for a new facility or for relocating an existing facility. States vary widely on all these dimensions. Differences in state and local taxes are actually of little significance when stacked up against differences in these other costs. On average, state-local taxes falling on businesses represent only about 1.2% of the total cost of doing business in the U.S. *See* LYNCH, *supra*, at 4. A tax incentive that reduces this tax burden, therefore, would obviously represent an even smaller percentage of the total cost of doing business.

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n. 15 (stating that "it is undisputed that States may try to attract business by creating an environment conducive to economic activity, as by maintaining good roads, sound public education, or low taxes").

For the vast majority of investment and location decisions, therefore, tax incentives will be swamped by differences in other economic factors. Labor costs, for example, are about 14 times the average state and local tax cost. *See* TIMOTHY BARTIK, WHO BENEFITS FROM STATE AND LOCAL ECONOMIC DEVELOPMENT POLICIES? 61 (1991). Thus even a tax incentive equal in value to 50% of the total state-local tax burden in a state would be more than offset by a mere 4% difference in wages between that state and another, because 4% of the wage bill is worth more than 50% of the annual tax bill. Furthermore, the incentive is temporary, while the wage difference may well persist for years. Thus we should expect, from the beginning, to find that tax incentives rarely tip the balance one way or the other; they would do so only in those few cases where the other cost factors are equal between two locations.

The effectiveness of tax incentives in stimulating economic activity can be researched by exploring the following hypotheses: If incentives are effective, then states or places that offer incentives should experience more growth than those that do not; states or places with larger incentives should experience more growth than those with smaller incentives; and states or places that adopt incentives should experience a higher growth rate after adoption than prior to adoption. These hypotheses can be tested statistically, by comparing growth across states to the incentives in those states, controlling for the other factors that influence growth rates. The hypotheses can be tested over time as well, comparing growth rates before and after the adoption or expansion of incentives, again controlling for other factors that changed over the time period in question.

Earlier studies (in the 1950s through the mid-1970s) generally concluded that incentives make little or no difference in the location or investment behavior of firms. *See, e.g.*, John Due, *Studies of State-Local Tax Influences on Location of Industry*, 14 NATIONAL TAX J. 163 (1961). Later studies that were more sophisticated methodologically found small effects.[10] One of the important differences is that these more recent studies found better ways to control for the influence of public services on growth. That is, they were better at finding the independent influence of incentives, holding all other factors (including public service levels) constant. It is important to understand what this means. What the recent studies found, in effect, is that states that offer larger incentives can expect some modest increase in economic activity provided that they can somehow do so without cutting public services.[11] The research findings are thus much more limited in scope than is often claimed, for they mean only that if a state can somehow be more efficient, providing the same level of services with lower taxes, then it will experience more economic growth (though not a lot more). It certainly does not mean that business tax incentives financed by service cuts will produce growth. *See* LYNCH, *supra*.

In the real world, state and local governments must, for the most part, balance their budgets. Business tax

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[10] For one of the earliest reviews of several studies showing positive effects, see Robert Newman & Dennis Sullivan, *Econometric Analysis of Business Tax Impacts on Industrial Location: What Do We Know, and How Do We Know It?*, 23 J. OF URBAN ECONOMICS 215 (1988).

[11] Reviews of these studies can be found in BARTIK, *supra*; LYNCH, *supra*; Peters & Fisher, *The Failures of Economic Development Incentives*, *supra*; and Wasylenko, *supra*.

incentives must be offset by cuts in spending or increases in other taxes. Studies have found that public services, particularly education and infrastructure, are important factors contributing to growth. *See* LYNCH, *supra*, at 43-46; *see also* Ronald Fisher, *The Effects of State and Local Public Services on Economic Development*, NEW ENGLAND ECONOMIC REVIEW 53 (March/April 1997). If a state provides business tax incentives and cuts services at the same time, the research suggests that the magnitude of the negative effects of the spending cuts could be enough to offset the positive effects of the tax cut. *See* LYNCH, *supra*; Fisher, *supra*. In fact, research indicates that tax increases that finance spending increases can actually provide some economic stimulus. *See* LYNCH, *supra* (discussing the results of five separate studies). The positive effects of spending may (depending on the nature of the spending) be greater than the negative effects of business tax increases. *Id.*

In the mid-1990s, some economists argued that a consensus of sorts had been reached on the long-term effectiveness of state business tax incentives. *See* Timothy Bartik, *Jobs, Productivity, and Local Economic Development: What Implications Does Economic Research Have for the Role of Government?*, 47 NATIONAL TAX J. 847, 852 (1994); Wasylenko, *supra*, at 49. The measure of their effectiveness is summarized in an elasticity: the percentage change in business activity produced by a given percentage change in tax incentives. The consensus was that this elasticity was around .2 or .3, which means that an incentive equivalent to a 10% cut in taxes would eventually produce a 2% to 3% increase in economic

activity, provided, again, that incentives were not accompanied by cuts in public services.[12]

Is this a large effect or a small effect? One way of addressing this question is to ask: Given that level of influence, how much of the economic growth experienced by a state will be attributable to the incentives? Public officials routinely assert or assume that the answer to this question is: All of it. Once incentives are adopted, all subsequent growth is attributed to the incentives, as if no growth would occur on its own. This assumes that tax incentives are always the decisive factor, which flies in the face of the evidence that other factors are much more important, and tax incentives are rarely the decisive factor.

A typical array of business incentives offered for the average manufacturing business is equivalent to about a 30% cut in the state and local tax burden over a period of 20 years. *See* PETERS & FISHER, STATE ENTERPRISE ZONE PROGRAMS: HAVE THEY WORKED?, *supra* at 113. What the research shows is that, given incentives of this magnitude, and given the more generous estimate of incentive effectiveness (an elasticity of .3), only about 1 in 11 business investments can be attributed to the incentives. *See id.* The rest of the investment would have occurred anyway. Moreover, the effects of service cuts necessitated by the incentives may well offset even these modest gains, reducing the 9% effectiveness to near zero.

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[12] An elasticity of .2 means that the percentage change in economic activity will equal .2 times the percentage change in taxes. This elasticity measures change over the long run; that is, the ensuing growth occurs not immediately but over a period of many years.

B. Tax incentives are costly

The crux of the problem for state governments is this: Since the vast majority of business decisions will hinge on factors other than taxes, when you offer tax incentives, you have to spend an enormous amount of money (in the form of tax breaks that were unnecessary) to get a small benefit. This makes the tax cut strategy expensive and wasteful. Furthermore, even that low level of effectiveness, gained at high cost, is attainable only if the state can finance the tax cuts in a way that does not drive business from the state. Cuts in spending on education and infrastructure will offset any gains from the tax cuts and in fact will damage the state's long-run economic prospects. Yet it will be difficult to finance significant tax cuts year after year without reducing spending for education, transportation, utilities, and public safety. Those categories account for the majority (55%) of state and local budgets.[13]

C. Tax incentives are an inferior policy tool given the alternative strategies available to encourage economic development

States have available to them a variety of strategies to foster economic growth. States invest in workforce development, for example, which benefits both the workers whose skills and earning potential are upgraded and the

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[13] This figure is calculated by dividing the sum of expenditure of all state and local governments in the U.S. for education, transportation, public safety, and utilities by the sum of direct general expenditure and utility expenditure. *See* UNITED STATES CENSUS BUREAU, 2002 CENSUS OF GOVERNMENTS, Table 1 (State and Local Government Finances by Level of Government and by State: 2001-2002), *available at* http://ftp2.census.gov/govs/estimate/02slsstab1a.xls.

businesses that then can draw from a pool of higher skilled labor. States invest in business development through university technology transfer programs, business incubation centers, small business development assistance, and support for the provision of venture capital. *See, e.g.*, PETER K. EISINGER, THE RISE OF THE ENTREPRENEURIAL STATE (1988) (analyzing state high technology initiatives and venture capital programs). Most importantly, states invest in public education, which is essential to the development of the kind of workforce demanded in a modern economy. And they provide, often through local government, the public infrastructure essential to economic activity: streets and highways, public transit, water and sewer systems, and police and fire protection.[14]

The common feature of all of these alternative strategies for enhancing state economic growth is that they are productive and important activities from a national perspective as well. They are not beggar-thy-neighbor approaches, but instead are efforts to reinforce and enhance the nation's economic base. Furthermore, they are not hampered by the fundamental problem with incentives: the asymmetry of information that leads governments to spend money without knowing whether or not it is needed (since the business investment likely would have occurred anyway). As such, these alternatives are bound to be more cost effective.[15]

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[14] Evidence of the importance of education, streets and highways, and public safety services on state economic growth can be found in Fisher, *supra*.

[15] Timothy Bartik is among those who have argued for a greater focus of state economic development policies on programs that enhance business productivity, and cites some evidence of the effectiveness of

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Far from creating irreparable harm to state economic development efforts, a court decision invalidating tax incentives would end a very inefficient, costly, and wasteful practice and free up state resources to devote to economic development strategies that are at once more cost effective to the states and beneficial, rather than harmful, to the national economy. From a constitutional perspective, the existence of these more effective economic development alternatives further undercuts the validity of discriminatory tax incentives like Ohio's ITC.

D. Incentive strategies are adopted for political, not economic, reasons

The economic war between the states continues unabated, not for sound economic reasons, but for a variety of political reasons. The opening of a new plant that benefited from tax incentives provides politicians with a valuable opportunity to take credit for something of tangible benefit to the state, even if the incentives in actuality played no part in the firm's decision. The investments in education and infrastructure that would be of greater long-term economic benefit, on the other hand, will produce results that are less tangible, harder to take credit for, and that occur long after most current elected officials have left office.

The political risk associated with "losing" a major employer, or failing to land a new manufacturing facility after an intense competition with other states, is enormous. The risk associated with spending money unnecessarily

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certain workforce training and technology programs. Bartik, *Jobs, Productivity, and Local Economic Development, supra*.

is small, particularly since, sooner or later, there will be business expansions or relocations somewhere in the state that can be attributed to the spending, and it will rarely be clear to the public that the spending was unnecessary. *See* Terry F. Buss, *The Effect of State Tax Incentives on Economic Growth and Firm Location: An Overview of the Literature*, 15 ECON. DEV. Q. 92 (February 2001). Furthermore, incentives can be couched as tax cuts, not spending programs, even though, as "tax expenditures," they are equivalent. It is difficult to run for office on a platform opposing tax cuts that appear to have little cost to the average taxpayer and that one's opponent will argue create jobs.

Thus the political incentives are all on the side of granting incentives. Benefits to the state can always be plausibly asserted, however weak the causal connection, and the costs in lost revenue are hidden. Disavowing tax incentives, on the other hand, presents great risks and few benefits to political leaders, as their opponents in the next election will attack them for failing to do all they could to capture development and increase jobs. It is no wonder that states, left to themselves, continue the race to the bottom.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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January 23, 2006

ADDENDUM

The *amici curiae* include the following economics and public policy scholars:

Randy Albelda is a professor of economics in the Public Policy graduate program at the University of Massachusetts, Boston. She has worked as research director of the Massachusetts State Senate's Taxation Committee and the legislature's Special Commission on Tax Reform. Her research and teaching covers a broad range of economic policies affecting low-income families. Her most recent work includes the edited volumes THE DILEMMAS OF LONE MOTHERHOOD: ESSAYS FROM FEMINIST ECONOMICS and LOST GROUND: POVERTY, WELFARE REFORM, AND BEYOND, and co-authored reports, *A Tale of Two Decades: Changes in Work and Family in Massachusetts 1979-1999* and *Beyond Welfare: Emergency Services in Massachusetts*. Other publications include the book, ECONOMICS AND FEMINISM: DISTURBANCES IN THE FIELD, co-authored books, GLASS CEILINGS AND BOTTOMLESS PITS: WOMEN'S WORK, WOMEN'S POVERTY; THE WAR ON THE POOR: A DEFENSE MANUAL; and UNLEVEL PLAYING FIELDS: UNDERSTANDING WAGE INEQUALITY AND DISCRIMINATION. She is the author or co-author of over 20 articles, ten book chapters and dozens of policy reports.

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Professor Chernick's research specializes in the economics of the public sector, with special attention to the distributional impacts of government spending and taxation. He is a recipient of the Presidential Award for Excellence for applied Scholarship, Hunter College, 2005. He is actively involved in public policy in New York, serving as a consultant to the City of New York Independent Budget Office and the Campaign for Fiscal Equity.

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IN THE

Supreme Court of the United States

DAIMLERCHRYSLER CORPORATION,
Petitioner,

v.

CHARLOTTE CUNO, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF OF *AMICI CURIAE* CITY OF ELYRIA, OHIO, CITY OF NORTH RIDGEVILLE, OHIO, CITY OF AVON LAKE, OHIO AND CITY OF AVON, OHIO IN SUPPORT OF PETITIONER

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INTEREST OF *AMICI CURIAE* [1]

Amici curiae, the Cities of Elyria, North Ridgeville, Avon Lake, and Avon, Ohio, are four chartered municipal corporations located in Lorain County in northeastern Ohio. They maintain that the Sixth Circuit's erroneous construction of the Commerce Clause and invalidation of Ohio's investment tax

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[1] This brief is filed with the written consent of all parties. Pursuant to Rule 37.6, no counsel for either party authored this brief in whole or in part, nor did any party make a monetary contribution to the preparation or submission of this brief.

credit set forth in O.R.C. § 5733.33 will have profoundly adverse impacts on their local economies. Thousands of jobs and millions of investment dollars are in jeopardy of being lost in Lorain County, Ohio, alone if the Sixth Circuit's decision invalidating the Ohio investment tax credit were permitted to stand.

Ohio should be free to "structure [its] tax system[] to encourage the growth and development of [its own] intrastate commerce and industry." *Boston Stock Exchange v. Tax Comm'n*, 429 U.S. 318, 336 (1977). This is central to Ohio's ability to hold its own in interstate competition with other states for economic development, manufacturing facilities and job creation. As this Court has emphasized, "competition among the States for a share of interstate commerce is a central element of our free-trade policy." *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 272 (1984).

Ohio's investment tax credit is central to the successful efforts of the State of Ohio and its political subdivisions to encourage new local capital investment by foreign and domestic manufacturing businesses alike. Because the four municipalities would be severely hampered in their ability to compete for economic development and revitalization of their industrial base without the ability to use incentives such as Ohio's investment tax credit, *amici* have a substantial interest in the outcome of this case.

SUMMARY OF THE ARGUMENT

The Ohio investment tax credit does not violate the dormant Commerce Clause. In fact, it promotes both interstate and intrastate commerce by providing incentives for additional economic development and capital investment in local communities in Ohio.

For a company with no presence in Ohio, the investment tax credit encourages the interstate location of new facilities in Ohio without any "coercion" from Ohio's franchise tax

because the company has no pre-existing Ohio tax liability and would be taxed (subject to the credit) only on its new business activities in Ohio. If, however, the foreign corporation chose to invest in another state instead of Ohio, there would be no Ohio tax liability and the investment tax credit would have no extraterritorial impact—neither increasing nor decreasing the corporation's franchise tax liability in another state.

For a company already present and conducting business operations in Ohio, the actual effect of the investment tax credit on its decision whether to invest in new machinery and equipment within or outside Ohio is the opposite of the Sixth Circuit's misassumption that any in-state benefit must create a corresponding out-of-state economic burden. If the company chooses to expand its existing business activities in Ohio, the in-state capital investment that boosts production and sales will typically ***increase*** the company's Ohio franchise tax liability which is calculated on both a net worth and net income basis and levied on the higher of the two tax computations. The partial tax credit usually offsets only a portion of the company's ***future*** tax liability as a result of its newly-augmented taxable base. O.R.C. §§ 5733.05(B) and (C); 5733.06. Conversely, if the corporation chooses to invest out-of-state rather than in Ohio, its Ohio franchise tax liability is likely to be reduced under Ohio's apportionment formula[2] because the out-of-state investment decreases the percentage of the company's Ohio business value and activity subject to taxation in Ohio vis-à-vis the company's aggregate activities measured on a national scale. Far from increasing the Ohio franchise tax burden on a company already doing business in Ohio, its out-of-state investments would add to the flow of interstate commerce and would generally ***reduce*** the company's pre-existing Ohio franchise tax liability. Thus, the Ohio investment tax credit neither burdens out-of-state

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[2] O.R.C. § 5733.05(B)(2).

economic activity, increases the tax liability of out-of-state actors, decreases the tax liability of in-state actors at the expense of out-of-state businesses, nor discriminates against interstate commerce.

The Ohio investment tax credit is unlike any aspect of state tax law that this Court has previously invalidated on dormant Commerce Clause grounds. The Court has emphasized that the Commerce Clause does not "prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry," *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 336 (1977), and that it is "a laudatory goal in the design of a tax system to promote investment that will provide jobs and prosperity to the citizens of the taxing State." *Trinova Corp. v. Michigan Dept. of Treasury*, 498 U.S. 358, 385 (1991).

The court of appeals seriously overreached in declaring the Ohio investment tax credit to be unconstitutional and in enjoining its enforcement. This Court should reject on intersecting Commerce Clause and federalism grounds the significant encroachment on the powers of a state to structure its tax system in order "to encourage the growth and development of [its] commerce and industry" that the Sixth Circuit's decision below represents.

ARGUMENT

THE OHIO INVESTMENT TAX CREDIT PROMOTES RATHER THAN BURDENS INTERSTATE COMMERCE.

Ohio's tax incentive for local investment does not discriminate against interstate commerce; in fact, it meaningfully promotes interstate commerce. This Court has explained that the "the Commerce Clause prohibits economic protectionism—that is regulatory measures designed to benefit in-state economic interests by burdening out-of-state competition." *Fulton Corp. v. Faulkner*, 516 U.S. 325, 330

(1996).[3] Ohio's investment tax credit neither seeks nor achieves economic protectionism. It rewards specific in-state economic development but provides no systematic advantage to local businesses, activities or transactions over out-of-state actors, activities or transactions. While the Ohio investment tax credit benefits ***local*** development—as all economic development incentives do—that is not the same thing as economic protectionism.

The Ohio investment tax credit does not discriminate against interstate commerce. Discrimination prohibited by the Commerce Clause "means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste Systems v. Department of Environmental Quality*, 511 U.S. 93, 99 (1994). The anti-discrimination principle is designed to invalidate protectionist laws that provide a competitive advantage to in-state businesses or in-state commercial activities.[4] But the Ohio investment tax credit does not discriminate against any entity on account of its out-of-state location, activities or transactions. Simply put, the Ohio investment tax credit poses no discriminatory burden on interstate commerce whatever. It does not, for example, tax out-of-state companies more for engaging in activities outside Ohio than in-state

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[3] Internal quotations from *Associated Industries of Missouri v. Lohman*, 511 U.S. 641, 647 (1994) and *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 273-74 (1988), respectively, omitted in the interests of clarity.

[4] *See, e.g., C&A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 390 (1994) ("[t]he central rationale for the rule against discrimination is to prohibit state or municipal laws whose object is local economic protectionism"); *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 817 (1976) (Stevens, J., concurring) (the primary purpose of the dormant Commerce Clause is "to inhibit the several States' power to create restrictions on the free flow of goods within the national market, rather than provide the basis for questioning a State's right to experiment with different incentives to business").

businesses for engaging in activities in Ohio; in fact, the effect of the investment tax credit is quite the opposite. Nor does it penalize any commercial actor for engaging in transactions or economic activities outside Ohio.

Suppose the existence of two identical manufacturing businesses. Each has decided to spend an identical amount of capital in the same tax year of 2005 for new equipment and machinery. One company has no Ohio operations or presence; the other company has had Ohio operations and an Ohio presence for a period of time longer than the preceding four years.[5] For the out-of-state company, the Ohio investment tax credit promotes interstate commerce by encouraging it to invest in new economic development in Ohio. This incentive is crucial to the ability of local governments to compete and attract businesses to relocate or expand their local operations.

If the out-of-state company decided to invest in new machinery and equipment in Ohio, it would be entitled to a credit equal to the entire 7.5% of its expenditures on new

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[5] The Ohio investment tax credit for new machinery and equipment purchased in 2005 and installed in Ohio would equal 7.5% of the difference by which the company's 2005 qualifying investments exceeded the annual average of its qualifying expenditures in Ohio during the three years 1999, 2000 and 2001. R.C. § 5733.33(C)(1). The credit so computed would then be spread in equal parts over the succeeding seven years through 2012, R.C. § 5733.33(C)(4), and credited against the company's Ohio franchise tax (based on the company's net worth) or income tax (based on net taxable income) liabilities in those years. R.C. § 5733.33(B)(1). In Ohio, a company calculates both its franchise tax and its income tax for each year, R.C. §§ 5733.05(B) and (C), and pays the higher of the two taxes. R.C. § 5733.06; *Wesnovtek Corp. v. Wilkins*, 105 Ohio St.3d 312, 2005-Ohio-1826, ¶ 2 ("[t]he Ohio franchise tax is an excise tax levied upon corporations for the privilege of doing business in the state, owning or using a part or all of its capital or property in this state, or holding a certificate of compliance authorizing it to do business in this state").

machinery and equipment installed in Ohio against the new franchise or income tax liability its new Ohio operations would generate, since it has no prior qualifying investments in Ohio. There would be no "coercion" created by the state's taxing power in the sense that concerns Professor Hellerstein[6] because the company would be taxed only on new activities in Ohio that generated new franchise tax or income tax liability.

If, however, the out-of-state company decided to make the investment in its home state, or in any other state for that matter, Ohio's investment tax credit has absolutely no effect on the company's tax liability. The company has no Ohio franchise or income tax liability, and the Ohio investment tax credit neither increases nor decreases the company's tax liability, if any, in the state in which it located the new investment of machinery and equipment.

The foregoing stands in stark contrast to protectionist state statutes that (i) impose greater tax liability on out-of-state economic activities than on identical in-state activities,[7] (ii) burden out-of-state consumers with greater tax liability than in-state consumers who are "substantially protected against the impact of the [tax],"[8] (iii) "impose[] greater burdens on economic activities taking place outside the State than were placed on similar activities within the State" and penalize increased out-of-state commercial activities even when the amount of in-state business remained constant,[9]

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[6] *See, e.g.*, Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789, 806-15 (1996).

[7] *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 332 (1977).

[8] *Maryland v. Louisiana*, 451 U.S. 725, 756, 757 (1981).

[9] *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 401 & n.9, 404 (1984).